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FLORIDA PUBLIC SERVICE COMMISSION
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M E M O R A N D U M

FEBRUARY 26, 1996

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF LEGAL SERVICES (ELIAS) *RVE*
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (SALAK) *JDJ*
DIVISION OF ELECTRIC AND GAS (JENKINS) *JMS*

RE: DOCKET NO. 950379-EI - INVESTIGATION INTO EARNINGS FOR
1995 AND 1996 OF TAMPA ELECTRIC COMPANY

AGENDA: MARCH 5, 1996 - REGULAR AGENDA
DECISION PRIOR TO HEARING - INTERESTED PERSONS MAY
PARTICIPATE.

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\LEG\WP\950379RC.RCM - APRIL 22, 1996,
HAS BEEN RESERVED FOR A HEARING, IF APPROVED.

CASE BACKGROUND

On March 1, 1995, Tampa Electric Company (TECO or the Company) submitted its 1995 Forecasted Earnings Surveillance Report in compliance with Rule 25-6.1353, Florida Administrative Code. Per the report, TECO forecasted an achieved return on equity (ROE) of 14.28% for 1995. This exceeded the top of TECO's then currently authorized ROE range (10.35% to 12.35%, with an 11.35% midpoint). Subsequently, additional data was requested and received for 1996 that indicated a projected ROE of 13.81%, which was later adjusted downwards to 13.07%.

Due to concerns over the high level of TECO's forecasted earnings, a meeting was scheduled on March 22, 1995, to explore alternatives regarding the possible disposition of the excess earnings. TECO, the Office of the Public Counsel (OPC), the Florida Industrial Power Users Group (FIPUG) and the Commission staff participated in the discussions at the meeting. As a result of this and subsequent meetings, a proposal was proffered concerning the disposition of the excess revenues for 1995 only. Per Order No. PSC-95-0580-FOF-EI, the Commission accepted Tampa Electric Company's proposal to: (1) establish a new return on equity of 11.75% with a range of 10.75% to 12.75%, effective January 1, 1995; (2) irrevocably defer a revenue amount of \$15

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

Docket No. 950379-EI
February 26, 1996

million for 1995; (3) defer 50% of any revenues in excess of an 11.75% ROE up to a net 12.75% ROE and to defer all revenues in excess of a net 12.75% ROE; (4) defer any deferred revenues until 1997 and accrue interest at the commercial paper rate; and (5) end the oil backout clause, effective January 1, 1996.

The best information available to staff, including TECO's own projections, indicates substantial overearnings are projected for 1996. On December 20, 1995, staff filed a recommendation that the Commission: 1) hold a limited proceeding to update the authorized ROE for TECO; and, 2) hold 1996 earnings in excess of the maximum of its currently authorized range of ROE subject to refund. At the January 3, 1996, agenda conference, the Commission denied staff's recommendations. Instead, the Commission approved the following plan proposed by the Company at agenda:

1. 50% of any actual revenues in excess of 11.50% ROE will be held subject to the Commission's jurisdiction up to a net earned ROE of 12.50% on an FPSC adjusted basis per December earnings surveillance reports for calendar year 1996. The company also agrees that any actual revenues in excess of the net 12.50% ROE will be held subject to the Commission's jurisdiction.
2. The 1996 revenues subject to Commission jurisdiction will be held until 1997 and will accrue interest at the thirty day commercial paper rate as specified in Rule 25-6.109, Florida Administrative Code. The revenues will be treated as if collected evenly throughout the year.
3. The calculation of the actual ROE for 1996 will be on an "FPSC Adjusted Basis" using the appropriate adjustments approved in Tampa Electric's last full price change proceeding (Docket No. 920324-EI). All reasonable and prudent expenses and investment will be allowed in the calculation and no annualized or proforma adjustments will be made.
4. Tampa Electric agrees to petition the Commission by March 1, 1997, to determine the specific method for disposition of the 1996 revenues and interest held subject to the Commission's jurisdiction.
5. The calendar year 1996 surveillance report on which the revenues held subject to Commission jurisdiction will be based, is subject to audit and true-up.
6. The Commission will retain jurisdiction over all revenues held subject to Commission disposition.

Docket No. 950379-EI
February 26, 1996

7. If through a protest, the Proposed Agency Action is nullified, Tampa Electric agrees that effective with a beginning date of January 3, 1996, 100% of any actual 1996 revenues in excess of a 12.75% ROE will be held subject to Commission jurisdiction. The calculation methodology will be the same as in Item Number 3 above.

By Order No. PSC-96-0122-FOF-EI, issued January 23, 1996, in this docket the Commission approved TECO's proposal as Proposed Agency Action. On February 13, 1996, FIPUG and OPC each filed a Protest of the Commission's Order. This recommendation addresses the protests.

DISCUSSION OF ISSUES

ISSUE 1: How should the Commission proceed on the Office of Public Counsel's and the Florida Industrial Power Users Group's protests of Order No. PSC-96-0122-FOF-EI?

RECOMMENDATION: The Commission should hold an expedited limited proceeding to consider the appropriate authorized return on equity for Tampa Electric Company. Staff has reserved April 22, 1996, for this purpose. The Commission should defer action concerning the Polk Power Station until later this year. The Commission should clarify, to the extent necessary, that the option of requiring a refund of 1996 overearnings (if any), is among those available to the Commission. Any decision as to the amount and disposition of TECO's 1996 overearnings should be deferred until after 1996's results are finalized.

STAFF ANALYSIS:

OPC's Protest

In its protest of Order No. PSC-96-0122-FOF-EI, OPC takes issue with the Commission's determination that 12.5% is the appropriate maximum authorized ROE for TECO.

OPC requests:

that an expedited hearing be conducted pursuant to the provisions of Section 120.57(1), Florida Statutes (1995), to determine a fair return on equity for Tampa Electric Company and to determine whether excess earnings for 1996 should be refunded to customers. The Citizens also request that the Commission hold a separate hearing in 1996 to determine how Tampa Electric's earnings for 1996 should be measured, with specific attention to the issue

Docket No. 950379-EI
February 26, 1996

of whether, and to what extent, investment and expenses associated with Polk Unit 1 should be included in a calculation of 1996 earnings.

Given that those portions of Order No. PSC-96-0122-FOF-EI that were issued as Proposed Agency Action are now a nullity, staff believes that an expedited hearing to consider the appropriate return on equity is appropriate. As implicitly recognized by the Commission in its Proposed Agency Action, staff believes the cost of equity has declined. Further, if TECO's proposal was in effect, all earnings in excess of 11.5% would have been shared by the ratepayers.

Tampa Electric Company's current authorized return on equity (ROE) is 11.75%, which the Commission approved in Order No. PSC-95-0580-FOF-EI issued on May 10, 1995. From April 1995 to February 1996 (estimated as of 2-26-96), the monthly average yield on 30 year Treasury bonds has dropped 111 basis points, from 7.35% to 6.24%. The six month moving average of the yield on 30 year Treasury bonds has dropped 133 basis points from April 1995 through January 1996. In addition to the drop in rates on government bonds, the average monthly yield on Aa-rated public utility bonds has declined 115 basis points from 8.17% in April 1995 to 7.02% in January 1996. The six month moving average of the yield on Aa-rate public utility bonds has dropped 124 basis points over this period. Staff believes this decline in long-term interest rates indicates a corresponding decline in the cost of equity.

The determination of whether excess earnings exist is a function of the company's authorized ROE. In TECO's situation where there is a high probability of overearnings, it is imperative that the company's ROE is reflective of current capital market conditions. Staff believes that TECO's current authorized ROE is not reflective of current market conditions. Therefore, Staff recommends that the Commission grant OPC's request to hold a limited proceeding hearing to set an authorized ROE for all regulatory purposes for TECO.

In its Protest of Proposed Agency Action, OPC also raises the issue of how TECO's newest generating facility, Polk Unit 1, should be treated in the calculation of 1996 earnings:

It is apparent from numbers mentioned at the agenda conference that Polk Unit 1, which is scheduled to come on line on October 15, 1996, will cost much more than originally anticipated. Yet, the proposed agency action does not provide for an evaluation of the in-service date or the prudence of the Polk unit in measuring the extent of earnings above 12.5%. The statement in the order that

Docket No. 950379-EI
February 26, 1996

the Commission retains jurisdiction over earnings above 12.5% is, essentially, meaningless because no one knows what it means. The retention of jurisdiction on this basis, alone, requires a protest so that customers will not find out, too late, that it meant the company gets to keep the money.

Staff is, and has been, investigating the costs associated with TECO's Polk Power Station. The costs associated with this unit will be better known after construction is complete and the unit placed in service. Currently, the unit is scheduled to be placed in service in mid October of this year. Deferring action until after that time will enable the Commission to render its decision based on more accurate and complete information than is currently available.

Based on a review of the tape recording of the January 3, 1996, agenda conference, it is clear that TECO's proposal included jurisdiction for the Commission to order a refund of 1996 overearnings, after any necessary determinations concerning the Polk Unit are made. Accordingly no party will be harmed by deferring action concerning the appropriate treatment of Polk Unit 1.

FIPUG's Protest

In its protest, FIPUG lists three disputed issues of fact:

- 1) Doubt as to the meaning of the term "revenues held subject to Commission Jurisdiction"
- 2) The impact of the Polk Power Station
- 3) No rationale for selecting a higher return on Equity

FIPUG asks that "if no amicable resolution of these issues can be agreed upon by May 1, 1996, Tampa Electric Company should be ordered to prepare minimum filing requirements with respect to those factual issues over which the parties cannot reach agreement."

As to the first point raised by FIPUG, staff believes that, as agreed by TECO at the January 3, 1996, agenda conference, holding 1996 excess earnings subject to Commission jurisdiction includes the authority to order a refund, if that action is determined by the Commission to be appropriate.

Docket No. 950379-EI
February 26, 1996

As to the second point raised by FIPUG, for the reasons set out above, the Commission should defer action concerning Polk Unit 1 until after the costs are finalized and the plant is placed in service. Issues concerning the return disparity, inter-generational subsidies, the prudence of the plant and the appropriate allocation of fuel savings can be better addressed after the final costs associated with the plant are known.

As to the third point raised in its petition, FIPUG suggests that 12.35 % is a more appropriate maximum authorized ROE for calculating 1996 excess earnings. 12.35% is the top of the range approved by the Commission in February, 1994, after a hearing in docket 930987-EI. 12.75% represents the top of the range of TECO's currently authorized return on equity. This was established without protest in Order No. PSC-95-0580-FOF-EI, issued May, 1995 in this docket. Staff believes that the concerns of both OPC and FIPUG regarding authorized ROE can be satisfactorily addressed at a hearing to establish the appropriate ROE for the Company.

Therefore, staff recommends that the following actions should be taken to address the protests filed by OPC and FIPUG: The Commission should hold an expedited limited proceeding to consider the appropriate authorized return on equity for Tampa Electric Company. Staff has reserved April 22, 1996, for this purpose.

The issues to be addressed at the hearing should be limited to:

1. What is the appropriate return on equity (ROE) for Tampa Electric Company (TECO) for all regulatory purposes?
2. What additional revenues, if any, should be held subject to refund?

The Commission should defer action concerning the Polk Power Station until later. The Commission should clarify, to the extent necessary, that the option of requiring a refund of 1996 overearnings (if any), is among those available to the Commission. Any decision as to the amount and disposition of TECO's 1996 overearnings should be deferred until after 1996's results are finalized.

Docket No. 950379-EI
February 26, 1996

ISSUE 2: Should this docket be closed?

RECOMMENDATION: No. This docket should remain open pending the hearing recommended in Issue 1 and until Staff has reviewed Tampa Electric Company's historical earnings data for 1995 and 1996, and the Commission has determined the amount, if any, and appropriate disposition of any overearnings. [ELIAS, SALAK]

STAFF ANALYSIS: This docket should remain open pending the hearing recommended in Issue 1 and until Staff has reviewed Tampa Electric Company's historical earnings data for 1995 and 1996, and the Commission has determined the amount, if any, and appropriate disposition of any overearnings. [ELIAS, SALAK]